



**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 8**

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7/13/2023

Mr. David Bruschwein, P.E.
Director
Division of Municipal Facilities
North Dakota Department of Environmental Quality
4201 Normandy Street
Bismarck, ND 58503-1324

Dear Mr. Bruschwein,

The U.S. Environmental Protection Agency (EPA), Region 8, has conducted an annual review of the North Dakota Drinking Water State Revolving Fund (DWSRF) for state fiscal year (SFY) 2022, which coincides with calendar year 2022, in accordance with the EPA's SRF Annual Review Guidance. The federal fiscal year (FFY) 2022 runs from October 1, 2021 through September 30, 2022.

The North Dakota Department of Environmental Quality (NDDEQ) is the DWSRF grantee and PWSS primacy agency, who develops the Intended Use Plan (IUP) and manages DWSRF projects. The North Dakota Public Finance Authority (PFA) provides financial management of the program, including evaluating a borrower's ability to pay, monitoring recipient's annual financial statements upon project completion, ensuring an independent audit is completed each year, and issuing bonds. The North Dakota DWSRF operates as a direct loan program that will episodically issue leveraged bonds if warranted by project demand.

This annual review summarizes EPA Region 8's evaluation of the technical, financial, legal, managerial, and operational capabilities and performance of the NDDEQ and PFA in administering the DWSRF. Activities incorporated into the annual review were an analysis of the 2022 and 2023 IUPs, 2022 annual report, audited 2022 financial statements, project files for two DWSRF funded projects (City of Bismarck 0800080-03 and City of Wing 0801036-01), two cash draws listed below, and information logged into the Drinking Water SRF Data System. An in-person annual review was conducted April 17-19, 2023, with the closeout meeting on April 19, 2023. Normally, four cash draws undergo transaction testing. However, North Dakota DWSRF had only two cash draws during SFY22.

FS998840-20	\$1,020,220	April 4, 2022
FS998840-19;	\$898,585	April 4, 2022

Observations

The state of North Dakota managed its DWSRF program during 2022 in accordance with applicable statutes, regulations, and guidance. The North Dakota DWSRF continues as a high-performing revolving loan fund that is committing and then using all project funds in a very timely manner. The state continues to experience strong water distribution/transmission project demand.

The state issued 15 new loans totaling \$23.7 million from its DWSRF in SFY22, all with an interest rate of 1.5 percent and a fee rate of 0.5 percent. Based on information from the SRF Data System and National Information System (NIMS) (which represents an offset time from the state fiscal year, July 2021-June 2022), the program closed 18 new loans for \$28.6 million, which includes re-finance loans. The funding breakdown was \$1.0 million for treatment, \$25.2 million for transmission and distribution, \$66,000 for source, and \$2.3 million for storage. Per the North Dakota 2022 Annual Report, since the inception of the DWSRF program, 317 loans totaling \$741 million have been closed.

In November, 2021, the Bipartisan Infrastructure Law (BIL) was signed into law, which appropriated federal DWSRF funding for FFY22-FFY26 for three types of infrastructure projects; supplemental DWSRF, lead service line (LSL) replacement and emerging contaminants (EC). In March 2022, EPA issued BIL Implementation Guidance and the FFY22 allotments. North Dakota DWSRF was awarded the FFY22 BIL grants December 21, 2022.

The FFY23 allotments for North Dakota were issued on April 3, 2023, as listed below. North Dakota DWSRF has recently submitted applications for all FFY23 DW base, DW BIL supplemental and DW BIL EC grants. The FFY23 DW BIL LSL grant has not yet been applied for, as statewide need and eligible projects are still being assessed.

DWSRF Supplemental:	\$21,055,000
Lead Service Line Replacement:	\$28,650,000
Emerging Contaminants:	\$7,640,000
DWSRF Base:	\$4,938,000

Throughout the five years of BIL Implementation, EPA expects North Dakota to:

- evaluate and revise, as needed, its disadvantaged community definition;
- evaluate the DWSRF's priority point system for project ranking commensurate with need;
- consider technical assistance funding; and
- engage residents and community stakeholders in disadvantaged communities.

Unliquidated Obligations

As of the end of SFY 2022, the North Dakota DWSRF had \$53 million in unliquidated obligations (ULO), achieving a spending rate of 82 percent. This spending rate has dropped from past years due to the large influx of BIL funds awarded in December 2022.

Additional Subsidy

North Dakota's DWSRF program has met its additional subsidy requirements through FFY21. For FFY22, the state has made \$5.3 million in additional subsidy commitments toward their total requirement for both base and BIL supplemental grants.

Given the original and congressional mandate for additional subsidy, the FFY22 and FFY23 base SRF capitalization grants each require between 26 percent (14% mandatory congressional plus 12% Safe Drinking Water Act Disadvantaged Communities) and 49 percent of the funds be provided as additional subsidization. The BIL supplemental and BIL LSL both require 49 percent additional subsidy. The BIL EC grant requires 100 percent additional subsidy. North Dakota SRF intends to meet these requirements.

The DWSRF program provides additional subsidy to disadvantaged communities as principal forgiveness and as extended loan terms. The disadvantaged communities definition is based on several factors: average annual residential user charge ratio with median household income, percent of households less than 200 percent of poverty threshold, percent of unemployment, and percent of residents with less than high school education.

Equivalency

North Dakota DWSRF will continue to fund projects to meet its FFY22 and FFY23 equivalency grant requirements and has met equivalency for all prior grants through FFY21. The program has begun planning equivalency projects specifically. For the 2022 base capitalization grant, the equivalency requirement will be met in-full with the following projects: Bismarck, Dickinson, Wing and Grand Forks. For the 2022 BIL supplemental capitalization grant, equivalency projects are identified for Bowbells, Cass RWD, Davenport, East Central RWD, Grand Forks, McLean-Sheridan RWS, Riverdale, Upper Souris, and Wilton. However, additional projects will be necessary to meet the full capitalization grant amount.

DWSRF Project Progress

For more traditional measures, the North Dakota DWSRF is summarized below with the following table, which presents fund use rate and pace of construction at the end of SFY2022.

North Dakota DWSRF Program Summary (\$ millions) December 31, 2022				
DWSRF Funds Available for Projects	Project Assistance	Fund Use Rate	Project Disbursements	Pace of Construction
\$770.5	\$748.1	97%	\$682.1	91%

Set-Aside Use and DWSRF-PWSS Integration

The set-aside spending rate for all base and BIL supplemental grants through FFY22 grants is 100 percent. The only set-aside funds that remain unspent are related to the FFY22 BIL LSL grant. The FFY22 BIL LSL grant was awarded December 21, 2022, just prior to the end of SFY22, so set asides were not able to be used. North Dakota is in the process of developing a contract to complete LSL inventories, which will begin drawing these LSL set aside funds in the summer 2023.

The state did not take any set-asides in their FFY22 base SRF, BIL supplemental or BIL EC grant. They are planning to use other state funds for program administrative costs and other technical assistance activities, separate of LSL inventories.

DWSRF Set-Aside Summary (\$ millions) December 31, 2022			
Set-Aside	Set-Aside Amount	Set-Aside Amount Expended	% of Set-Aside Expended
Administrative	\$10.7	\$9.6	89%
Small System TA	\$4.0	\$3.4	86%
State Program	\$6.4	\$3.6	56%
Local Asst.	\$3.2	\$0.4	13%
TOTALS	\$24.4	\$17.1	70%

From an organizational standpoint, the DWSRF and drinking water program are both in the Municipal Facilities Branch at North Dakota Department of Environmental Quality. The programs coordinate extensively.

Financial Indicators

As of December 31, 2022, North Dakota's DWSRF *fund use rate* was 97 percent, which is a decrease from past years, due to the infusion of BIL funds, but remains an excellent rate. The *pace of construction* (disbursements divided by total project amounts) remained constant at 91 percent, for the third consecutive year. Overall, North Dakota DWSRF staff manages project awards and disbursements in a timely manner.

North Dakota's cumulative DWSRF *Federal Return* increased slightly from 2.83 to 2.93 in 2022. In general, North Dakota's federal return is increasing with the longevity of the SRF program. For the overall "flow of North Dakota DWSRF funds" as of December 31, 2022, the construction disbursements (\$682.1 million) divided by total DWSRF funds available (\$754.5 million) was 90 percent. This is slight decline from last year, attributed to the infusion of BIL funds.

A key component of strategic SRF fund management is the balancing of cash inflows and outflows. The following ratio shows how efficiently North Dakota's DWSRF is revolving by examining the program's disbursement rate over a set time and comparing it to the amount of cash on hand. The ratio is calculated

by subtracting total project disbursements (\$682.1 million) from total funds available (\$754.5 million) and comparing this number (\$72.4 million) to the average annual disbursements over the past three years (\$39.8 million). For the North Dakota DWSRF, this ratio is 1.82 (years), which is an excellent outcome especially given the large infusion of BIL funds.

Per the SRF Data System/NIMS, the North Dakota DWSRF project milestones accomplishments as of June 30, 2022 are as follows (in \$ millions). The percentage of project completions to funds available is 82 percent. This number is an increase from last year's percentage of 76 percent.

- DWSRF Funds Available: \$712.3
- Project Assistance: 311 projects at \$731.8
- Construction Starts: 306 at \$725.2
- Project Completions: 266 at \$630.0

Financial Sustainability

Based on information from SRF Data System/NIMS the North Dakota DWSRF's *Net Return (Excluding Subsidy)* decreased slightly from \$25.2 million to \$23.7 million as of June 30, 2022. For July 1, 2021 through June 30, 2022, the state collected \$7.1 million in interest payments, \$214,000 in interest earnings and \$20.6 million in loan principal repayments. For this same time, the state paid \$7.3 million in leveraged bond principal payments, \$2.1 million in state match bond principal and \$6.7 million in bond interest expense.

The *Net Return on Contributed Capital excluding Subsidy* (contributed capital being the sum of federal outlays for loan fund and deposited state match) is 7.7 percent, which is decrease from 9.6 percent in 2021 and several years previous. The decline is largely due to the increase in leveraged bonds to meet the project demand for SRF loans. For a DWSRF that relies on state match bonds and occasionally issues leveraged bonds, these returns remain good. Attached to this report is a table that shows each indicator in further detail.

Total Net and Net Interest Margin

Total Net measures the extent by which internal growth is generating additional funding for new projects. This is calculated by taking the total cash inflows generated by ongoing loan and investment activity and subtracting debt service payments from outstanding match bonds. New federal capitalization grants are excluded from this calculation. The measure reflects the amount of new annual project funding that is generated solely from net repayments. For SFY22, the North Dakota DWSRF's *total net* was \$11.8 million and was consistent with the previous year.

Net Interest Margin measures the percentage rate of return the SRF is generating from its Total Assets through loans and investments after accounting for the interest expenses associated with match bonds. It does not include match bond principal as an expense. Currently, EPA does not have a modeling tool to estimate the state SRF program total assets, so the net interest margin cannot be calculated. However, net interest can be tracked from year to year. Net interest expenses for SFY22 totaled \$7.08 million, which is nearly identical to SFY21.

Financial Management and Proportionality

The DWSRF shows sound financial health and management. There have been no defaults and all municipal loans are secured by revenues from user charges and/or full faith and credit of the borrowing entities. The statement of net position as of December 31, 2022 was \$283.1 million, which increased slightly from the 2021 net position of \$282.5 million. Since the state has deposited and disbursed match prior to drawing federal funds, both base grant cash draws listed on page one (above) were completed with a 100 percent federal proportion. Furthermore, the payment requests were for eligible costs and were adequately documented. No costs were questioned, and there were no improper payments.

On February 23, 2023, Brady, Martz & Associates, P.C. issued audited financial statements on the DWSRF for the year ending December 31, 2022. The auditors expressed an unqualified opinion, indicating that the financial statements present fairly, in all material respects, the financial position of the North Dakota DWSRF in conformity with generally accepted accounting principles. The single audit for North Dakota SRFs was completed on February 23, 2023 and no findings were reported.

Prior Recommendations

There were no recommendations from last year's review.

New Recommendations

There are not any new recommendations with this review.

The North Dakota DWSRF assessment has been completed by SRF Coordinator, Emily Gillespie, in collaboration with the EPA Region 8 SRF team. If you have questions, you may contact Emily at Gillespie.Emily.J@epa.gov or (406) 457-5009.

Sincerely,

Benjamin Bents
Branch Chief
Technical and Financial Services Unit

cc: Ms. DeAnn Ament, Executive Director, ND PFA
Ms. Shannon Fisher, DWSRF Program Manager, ND DEQ

NORTH DAKOTA DWSRF; Section 1452 Funds
DWSRF FINANCIAL INDICATOR WORKSHEET Cumulative Data (\$ thousands)

Cumulative Data

At State Fiscal Year End	Dec. 31 2018	Dec. 31 2019	Dec. 31 2020	Dec. 31 2021	31-Dec 2022
Fund Use Rate					
DWSRF Assistance Provided	\$606,565	\$646,081	\$686,776	\$721,245	\$ 748,055
DWSRF Funds Available	620,775	642,587	663,860	687,890	\$ 753,877
North Dakota DWSRF Fund Use Rate	98%	101%	103%	105%	99%
DWSRF Funds Available:					
Net Capitalization Grants into the Loan Fund	190,836	200,729	210,254	221,659	\$ 248,880
Total State Match	51,432	51,432	51,432	51,432	\$ 76,432
Net Funds Provided from Leveraged Bonds	193,942	193,942	193,942	193,942	\$ 193,942
Net Return*	27,158	27,121	26,204	25,187	\$ 23,697
Net Principal Repayments	134,952	146,908	159,573	173,214	\$ 189,470
Transfer from CWSRF	51,516	51,516	51,516	51,516	\$ 51,516
Transfer to CWSRF	(29,061)	(29,061)	(29,061)	(29,061)	\$ (30,061)
DWSRF Funds Available	620,775	642,587	663,860	687,890	\$ 753,877
Additional DWSRF Projects Due to Leveraging					
DWSRF Assistance Provided	\$606,565	\$646,081	\$686,776	\$721,245	\$ 748,055
DWSRF \$ Available w/out Leveraged Bonds	426,833	448,645	469,919	493,948	\$ 559,935
Additional DWSRF Projects Due to Leveraged Bonds	179,732	197,436	216,857	227,297	\$ 188,120
DWSRF \$ Available w/out Leveraged Bonds:					
Net Capitalization Grants into the Loan Fund	190,836	200,729	210,254	221,659	\$ 248,880
Total State Match	51,432	51,432	51,432	51,432	\$ 76,432
Net Return*	27,158	27,121	26,204	25,187	\$ 23,697
Loan Principal Repaid	134,952	146,908	159,573	173,214	\$ 189,470
Transfer from CWSRF	51,516	51,516	51,516	51,516	\$ 51,516
Transfer to CWSRF	(29,061)	(29,061)	(29,061)	(29,061)	\$ (30,061)
DWSRF \$ Available w/out Leveraged Bonds	426,833	448,645	469,919	493,948	\$ 559,935
Loan Principal Repayments	\$192,227	\$209,382	\$229,500	\$250,105	\$ 273,615
Leveraged Bond Principal Repayments	57,276	62,475	69,928	76,891	\$ 84,145
Net Principal Repayments	134,952	146,908	159,573	173,214	\$ 189,470
Project Disbursements	530,149	580,132	625,574	654,506	\$ 682,146
Federal Cash Draws for Projects	198,226	208,260	219,718	231,263	\$ 233,182
Return on Federal Investment	2.67	2.79	2.85	2.83	2.93
Project Disbursements	530,149	580,132	625,574	654,506	\$ 682,146
DWSRF Assistance Provided	606,565	646,081	686,776	721,245	\$ 748,055
Pace of Construction	87%	90%	91%	91%	91%
Project Disbursements	530,149	580,132	625,574	654,506	\$ 682,146
DWSRF Funds Available	620,775	642,587	663,860	687,890	\$ 753,877
Overall Flow of DWSRF Funds	85%	90%	94%	95%	90%
Undisbursed Project Funds	90,626	62,455	38,286	33,383	\$ 71,731
3-year Average Annual Disbursements	66,189	72,766	71,568	53,554	\$ 39,781
Ratio of Undisbursed Funds to Disbursements	1.37	0.86	0.53	0.62	1.80
Set-Aside Expenditures	14,276	15,323	16,608	17,068	\$ 17,068
Set-Aside Payments	16,694	17,806	18,492	17,068	\$ 24,439
Set-Aside Spending Rate	86%	86%	90%	100%	70%
NIMS Report Data July-June	30-Jun 2018	30-Jun 2019	30-Jun 2020	30-Jun 2021	30-Jun 2022
Interest Payments	\$52,932	\$59,049	\$65,858	\$72,938	\$ 80,021
Interest Earnings	47,138	50,082	52,004	52,799	\$ 53,013
Bond Interest Expense	(55,988)	(63,070)	(70,408)	(77,304)	\$ (83,999)
Match Principal Repaid	(16,925)	(18,941)	(21,250)	(23,246)	\$ (25,338)
Net Return Excludes Subsidy	27,158	27,121	26,204	25,187	\$ 23,697
Net Return*	\$27,158	\$27,121	\$26,204	\$25,187	\$ 23,697
Contributed Capital*	241,348	250,888	261,686	261,686	\$ 308,244
Net Return on Contributed Capital*	11.25%	10.81%	10.01%	9.62%	7.69%
ANNUAL DATA					
Interest Payments	5,199	6,117	6,809	7,080	\$ 7,083
Interest Earnings	2,270	2,944	1,703	794	\$ 214
Loan Principal Repayments	19,433	17,044	17,395	19,611	\$ 20,584
Leveraged Bond Principal Repaid	(4,889)	(5,199)	(7,453)	(6,964)	\$ (7,254)
Match Bond Principal Repaid	(2,009)	(2,016)	(2,140)	(1,996)	\$ (2,092)
Bond Interest Expense	(3,998)	(7,082)	(7,339)	(6,896)	\$ (6,695)
TOTAL NET	16,006	11,809	8,975	11,630	\$ 11,840